UNITED STATES OF AMERICA
BEFORE THE
FEDERAL TRADE COMMISSION

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COMMENTS REGARDING RETAIL ELECTRICITY COMPETITION

COMMENTS

OF

INDUSTRIAL ENERGY CONSUMERS OF PENNSYLVANIA
INDUSTRIAL ENERGY USERS-OHIO
CONNECTICUT INDUSTRIAL ENERGY CONSUMERS
WEST VIRGINIA ENERGY USERS GROUP
COALITION OF MIDWEST TRANSMISSION CUSTOMERS

David M. Kleppinger
McNees, Wallace & Nurick
100 Pine Street
P.O. Box 1166
Harrisburg, PA 17108-1166
Phone: 717-237-5214
FAX: 717-237-5300
E-mail: dkleppin@mwn.com

Robert A. Weishaar, Jr.
McNees, Wallace & Nurick
1200 G Streeet, N.W.
Suite 800
Washington, DC 20005
Phone: 202-434-8991
FAX: 202-347-0988
E-mail: rweishaa@mwn.com

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INTRODUCTION

Industrial Energy Consumers of Pennsylvania ("IECPA"); West Virginia Energy Users Group ("WVEUG"), Industrial Energy Users – Ohio ("IEU-OH"), the Connecticut Industrial Energy Consumers ("CIEC"), and the Coalition of Midwest Transmission Customers ("CMTC") (collectively, "Industrial Customers") hereby submit Comments in response to the Federal Trade Commission's ("FTC" or "Commission") "Notice Requesting Comments on Retail Electricity Competition Plans" ("Notice").

IECPA was formed to address generic energy issues before governmental bodies and other organizations in the Commonwealth of Pennsylvania. IECPA is a 32-member group of industrial energy consumers. IECPA member companies collectively consume over 6 billion kWh of electricity in Pennsylvania alone. More than 100,000 Pennsylvanians are employed by IECPA member companies at nearly 200 plant locations.

WVEUG is an ad hoc association of energy-intensive industrial customers receiving electric service from Potomac Edison Company ("Potomac Edison") and from Monongahela Power Company ("Mon Power"), both of which are Allegheny Power subsidiaries operating in West Virginia. WVEUG members have been extremely active in the West Virginia electric restructuring process.

IEU-OH is an association of large Ohio industrial energy consumers that collectively spend over $2 billion per year for electricity and natural gas, and employ over 200,000 people in Ohio. IEU-OH's members work together to address matters affecting the availability and price of energy and related services. IEU-OH seeks to promote rational and consistent policies that will assure an adequate, reliable, and efficient supply of energy for all consumers at competitive prices. IEU-OH members regularly participate

in federal and state regulatory proceedings that may affect the availability and pricing of energy and natural gas.

CIEC represents industrial end-users that collectively employ over 40,000 Connecticut workers at numerous plant locations throughout the state. CIEC members consume approximately 1 billion kilowatt-hours of energy annually. The price of electricity is a substantial component of CIEC members' production costs. These energy costs are a significant element of the member companies' respective costs of operation.

CMTC is an ad hoc coalition of large consumers of electricity that operate manufacturing facilities and offices throughout the Midwest. CMTC members' Midwest manufacturing facilities consume more than 3.1 billion kilowatt-hours of electricity annually. CMTC members purchase electricity at retail from electric utilities that are participating in the Alliance collaborative and from electric utilities that are signatories to Midwest ISO agreements.

Industrial Customers work with electric distribution companies; electric generation suppliers; the Pennsylvania Public Utility Commission; the West Virginia Public Service Commission; the Connecticut Department of Public Utility Control; the Public Utilities Commission of Ohio; state legislatures; the Federal Energy Regulatory Commission ("FERC"); and with various regional organizations, including PJM Interconnection, LLC ("PJM"), the New England Power Pool ("NEPOOL"), ISO New England, the Midwest Independent System Operator ("MISO"), the New York ISO ("NYISO"), the Mid-Atlantic Area Reliability Council ("MAAC"), the East Central Area Reliability Council ("ECAR"), and the Northeastern Reliability Council ("NERC") to promote development of competitive electric markets, ensure the reliability of the electric system, and address issues that affect the price and availability of electricity.

Industrial Customers commend the Commission for launching a comprehensive analysis of retail electric competition to assist Congress in its ongoing efforts for comprehensive energy reform. Current conditions in California, dysfunctionality in transmission system operation throughout the Midwest, and price escalation and volatility in the Northeast underscore the importance of the issues that the Commission raises in its Notice.[1]

Industrial Customers do not endeavor to answer each and every one of the numerous questions posed in the Notice. Instead, Industrial Customers endeavor to identify the underlying causes of continued dysfunctionality in wholesale markets, which is the primary inhibitor of retail access development. Industrial Customers' Comments focus primarily on wholesale market structure and market power issues, which remain within the province of the FERC, not within the province of any particular state legislature or regulatory commission. While state actions are required in certain areas, state action alone cannot prevent market abuses or rectify flawed market structures, which originate at the wholesale level. Electric power markets function in close correlation to the physical supply grids in each region. The physical networks are regional in nature and, as such, transcend state borders. Given the configuration and interconnectedness of regional electric grids, it is impossible for any state (with the possible exception of Texas) to act in isolation. No state can single-handedly police market participants adequately, ensure the safe and reliable operation of the physical system, or ensure adequate generation capacity.

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[1] Explanations of the deficiencies in Midwest and Northeast power markets can be found in "Investigation of Bulk Power Markets: Midwest Region" ("Midwest Market Report") and "Investigation of Bulk Power Markets: Northeast Region" ("Northeast Market Report"), both of which were conducted by FERC Staff and released on November 1, 2000. Both Reports are available on the FERC's website at www.ferc.fed.us.

Industrial Customers believe that the most critical and urgent remedies are required at the wholesale level.

RECOMMENDATIONS

For reasons discussed below, Industrial Customers offer the following recommendations for facilitating the development of truly competitive and dynamically efficient wholesale markets that will provide the necessary platform for successful retail access implementation:

1. Regional market seams must be eliminated in a manner consistent with the rational development of competitive markets.

2. Markets must be actively monitored by government agencies and independent regional market monitors, and remedies for market abuses must redress the harm and be sufficient to deter future misconduct.

3. Market structures and rules must provide end-use customers with proper incentives and opportunities to respond flexibly to high system demand and high market prices.

4. Independent system operators ("ISOs") and regional transmission organizations ("RTOs") must allow end-users to actively and meaningfully participate in, and influence, the development of competitive market rules and structures.

COMMENTS

1. Regional Market Seams Must Be Eliminated In A Manner Consistent With Rational Development of Competitive Electricity Markets.

Seams that exist among the multitude of control areas throughout the United States create market inefficiencies, impede the free-flow of energy, and enhance opportunities for the acquisition and exercise of market power in localized circumstances. Interconnection-wide energy markets must evolve, which requires establishment of common market mechanisms, common business practices, common transmission congestion methodologies, common available transfer capability ("ATC") calculations, common generation interconnection protocols, common transmission planning approaches, and common approaches for resolving all other obstacles to the free-flow of energy within commercially defined markets. Vestiges of the monopoly integration of transmission and generation and historical power pool development must not impede the development of large, regional, competitive electricity markets. Changes to the status quo balkanization must occur; the question is how soon and in what manner. Industrial Customers recommend a measured approach to seams elimination that avoids or minimizes the adverse market impact of any "flash-cut" approach. During this transition period, all existing seams must be managed to produce outcomes that are not inconsistent with continued development of competitive markets.

The FERC began the process of wholesale competition in earnest with the issuance of Orders 888 and 889. While providing a useful starting point, however, these Orders alone were not sufficient to ensure an appropriate transmission platform for continued development of competitive generation markets. In recognition of the need for further impetus, the FERC issued Order 2000 to encourage development of RTOs that

demonstrate certain Minimum Characteristics and Functions that, in the FERC's perception, are necessary to ensure open, non-discriminatory access to monopoly-owned transmission systems. While Order 2000 provides a useful blueprint for the attributes of an RTO and the need for commonality throughout broad geographic regions, the Order assumes that monopoly transmission owners, including vertically integrated monopoly transmission owners, will voluntarily align themselves in a manner conducive to the development of competitive markets. Not surprisingly, Order 2000 has, to date, not yielded the transmission owner performance that is necessary for establishment of useful RTOs. Much more remains to be done to eliminate the pernicious seams that exist between emerging regional markets. FERC Staff recognizes the need for seams elimination, but the FERC has been unwilling to affirmatively require action on the part of ISOs and transmission owners to eliminate market seams.[2] In the Midwest, for example, Midwest state commissions have consistently and uniformly urged the FERC to take a more active role in eliminating the transmission impediments to a competitive Midwest energy market. The FERC has been extremely hesitant in responding. The FERC must be required to go beyond voluntary compliance with Order 2000, and effect the widespread seams elimination that is necessary for continued development of competitive electricity markets.

Differences in market rules and structures impede the free flow of energy in some circumstances and, in other circumstances, unnaturally dictate the flow of energy. For example, the lack of coordinated generation redispatch between PJM and the NYISO

[2] See, e.g., Northeast Market Report, p. I-91 ("The differences in the rules, procedures, and implementation software that now exist, even before expansive redesign of ISO-NE and before PJM embarks on offering additional market-based ancillary services, present barriers to trade and create inefficiencies. Greater coordination and standardization among the ISOs would add efficiencies to the market.").

substantially increases the likelihood that transmission line-loading relief ("TLR") will be implemented for transactions between PJM and New York. The technology and wherewithal exists to allow market-driven solutions to transmission congestion issues on transmission inter-ties; however, the political will to mandate such solutions has been ineffective. A common congestion management approach would resolve this "seams" issue and provide additional certainty that transactions will not be subject to physical curtailment. The problem is well-known and solutions are feasible, but the political will to date has been lacking. The existence of "seams" issues created by market rules differences also exists on the PJM-East Central Area Reliability Council ("ECAR") border. PJM market rules require all load-serving entities ("LSEs") to acquire unforced capacity or capacity credits to satisfy an installed capacity ("ICAP") obligation for their load. At the same time, the PJM energy market operates under a reasonable $1,000 per MWh bid cap. Areas to the west of PJM, by contrast, impose no ICAP obligation and do not cap energy market bids. Such disparate rules create a potentially profitable opportunity for generators to engage in "market rules arbitrage."

Market rules arbitrage magnifies generation adequacy risks and price volatility for both regions as peak period supply is actually encouraged to jump from market to market depending on the implications of the disparate market rules in any given hour. These movements are not based on reasonable economic or physical supply needs. Rather, they are based upon the opportunity of suppliers to "skim the cream" of the most advantageous administrative rules available at the moment while, in the process, creating the risk of real capacity deficiencies in one region or the other.

In the western region of the country, California operates under different rules from other states in the region. As such, California's efforts to remedy reliability and pricing

anomalies are frustrated as suppliers took advantage of the arbitrage between the neighboring states and California. Differences in market rules create seams that impede the free flow of energy, threaten reliability, and increase price volatility. Larger, more regionalized seamless markets must be developed.

Seams elimination has been receiving increasing, but still woefully inadequate, attention from the FERC and transmission owners, notwithstanding the efforts of state commissions and various stakeholder groups. For example, various entities in the Midwest recently executed and filed with the Commission a Settlement Agreement concerning RTO issues.[3] Included with the Settlement Agreement is an Inter-RTO Coordination Agreement that is designed to facilitate resolution of all market seams and differences between the Midwest ISO and the Alliance RTO. While the written agreement provides a starting point, much remains to be accomplished to achieve the Settlement's stated objectives. Similar efforts are underway in the Northeast among PJM, ISO New England, NYISO, and the Ontario Independent Market Operator pursuant to a Memorandum of Understanding executed by all four independent operators. While these efforts demonstrate some progress toward seams elimination, they must be actively directed by the FERC if they are to provide meaningful outcomes. Accordingly, Industrial Customers strongly encourage prompt federal action to provide impetus to seams elimination efforts in emerging regional markets.

Seams must be eliminated in a manner that encourages the continued development of fledgling electricity markets. A flash-cut, across-the-board implementation of common rules may undermine the limited positive developments that have occurred to date.

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[3] The Settlement Agreement was filed on March 21, 2001, under FERC Docket Nos. ER01-123-000, et al. The filing is accessible through the RIMS program on the FERC website at www.ferc.fed.us.

Industrial Customers recommend that seams elimination focus first on differences in operational practices (e.g., ramping times, scheduling parameters) that have been driven primarily by historical practice. Stakeholders should pick the "low-hanging fruit." Reconciliation of more substantial market rule changes (e.g., ICAP) will necessarily take time – both to identify and craft rules around best practices and to allow market participants to understand and conform to the new rules. A staged approach, identification of preferred practices, and allowance for market reaction time must all be recognized as the seams elimination process moves forward. In the interim, existing seams must be managed to produce outcomes that support continued market development. Importantly, as discussed in Number 4, below, all seams elimination efforts must be subject to stakeholder participation representative of the competing interests of supply and demand.

2. **Markets Must Be Actively Monitored by Government Agencies and Independent Regional Market Monitors, and Remedies for Market Abuses Must Redress the Harm and Be Sufficient to Deter Future Misconduct.**

This Commission, the FERC, state regulatory commissions, the Department of Justice, and all other entities that could exercise jurisdiction over electric generation must become particularly vigilant against the acquisition and abuse of market power. Additionally, as suggested (but not required) by Order 2000, all regional markets must be subject to comprehensive market monitoring by an independent entity. The electric industry is in dire need of clearly articulated standards for market power, and mechanisms to detect and fully remedy market anomalies in real-time. To date, no regulatory body has sufficiently exercised its authority to prevent and eliminate the acquisition and exercise of market power. As a result, market participants' and end-use customers' confidence in wholesale markets is eroding rapidly.

The fact remains that in most regional markets, a substantial amount of generation capacity is controlled by a limited number of suppliers. Limited market suppliers with certain types of generation, along with current market pricing schemes, provide opportunities for the gaming of bids to manipulate prices. For example, in PJM, combustion turbine ("CT") ownership remains relatively concentrated in PJM. Because CTs typically operate at the margin, this residual concentration of CT ownership enhances the possibility of prices on peak days that exceed marginal costs and all reasonable calculations of opportunity costs. Last July, the Wall Street Journal reported such actions in the PJM System and the FERC is currently indicating that such actions have occurred and are still occurring in Western markets. The problem of inflated prices exists both in markets that are perceived to be dysfunctional (e.g., California) and, importantly, in markets that are generally perceived to be "workably competitive" (e.g., PJM).

While the potentiality of market power abuse may remedy itself in time as new participants add generation, one must question how long customers will remain exposed to economic harm and price abuse while market corrections develop. For example, PJM coordinates a daily Capacity Credit Market, in which the price from September 15 to December 31 did not exceed $1.50/MW/day. However, from January 2001 through March 2001, the same market did not clear at less than $150/MW/day, a hundred-fold increase in the market-clearing price essentially overnight. Then, beginning April 1, 2001, the price began clearing again at or near $0/MW/day. Examples such as this Capacity Credit Market phenomenon in PJM underscore that market anomalies and, likely, pervasive gaming of market rules are not just issues in California; they remain issues in all electricity markets.

The FERC has, on occasion and upon request, eliminated dysfunctional market mechanisms (e.g., the ISO New England-coordinated Operating Capability market) and the Department of Justice has shown some interest in regional market mechanisms by launching a Notice of Inquiry into New England capacity markets. However, it appears to consumers that no systemic, continuous, and proactive market monitoring is occurring among federal or state agencies. If competitive wholesale markets are to evolve, several market protections must be put in place. First, independent market monitors must be put in place in all regional markets and must have the authority to obtain all necessary data to determine the existence and exercise of market power; to detect potential "loopholes" in market rules; and otherwise prevent pricing that is inconsistent with a fully functioning, workably competitive market. PJM's Market Monitoring Unit ("MMU"), for example, performs admirably, but continues to be hampered by limitations on its authority to obtain all necessary data to comprehensively monitor all PJM electricity markets and independently recommend market rule changes to improve the economic efficiency of those markets. Second, jurisdictional agencies must pay closer attention to the functioning of existing wholesale electricity markets. To date, the FERC has purportedly conducted investigations into allegations of market power and market abuses, but has been extremely reluctant to pursue such investigations formally in response to complaints by market participants. Moreover, the FERC readily approves proposed mergers, despite concerns about potential increases in generation ownership concentration, and readily approves requests for market-based pricing authority based on little or no analysis of the unique position of the applicant in a respective market. The FERC, and other jurisdictional entities must enhance their vigilance of electricity markets, particularly during this transition period, to ensure that market rules, practices, and procedures are working to

produce competitive outcomes. Third, the FERC should be given the authority to order refunds of "ill-gotten" gains in the event the FERC concludes that an entity exercised market power to increase price. The differential between competitive and anticompetitive market prices must be calculated and refunded to those who were adversely affected by the anticompetitive behavior. The expansion of the FERC's authority in this regard would require an amendment to Section 206 of the Federal Power Act, which currently limits remedies to period after issuance of a FERC Order. Also, Industrial Customers strongly support other jurisdictional agencies' full use of their remedial authority, including aggressive prosecution of illegal behavior and imposition of penalties when appropriate, both to redress anticompetitive results and to deter future anticompetitive conduct.

These enhancements to market monitoring, reporting, and enforcement are absolutely necessary to ensure continued development of competitive markets and to maintain the credibility of those markets vis-à-vis market participants.

3. Market Structures And Rules Must Provide End-Use Customer Loads With Proper Incentives and Opportunities To Respond Flexibly To High System Demand and High Market Prices.

The FERC, state regulatory commissions, and noted economists have universally indicated that: (1) demand elasticity is critical to the development of a dynamically efficient electricity market, and (2) demand elasticity is noticeably absent from existing wholesale electric markets. A rational response to wholesale market dysfunctionality must include positive incentives and market structures to allow load to be more responsive to price.

A central theme in considering market structures, particularly price-responsiveness, is the consistency of treatment between generators and end-use customer loads. The checks and balances required for a market to exist in a form that protects both suppliers

and consumers requires consistent application of opportunities and benefits for both suppliers and consumers. For example, market rules are typically structured to allow real-time dispatch of generation units, at market-based bids, to provide additional supply during high-demand and high-price hours. The rules favor supply increases, over demand reductions, as the initial response to capacity shortage situations. The result is higher prices and greater price volatility as CTs are dispatched at extremely high prices. However, comparable rules currently do not exist across-the-board to provide the same incentives and opportunities for demand reductions during capacity shortage periods. The playing field must be balanced.

Indeed, one of the most significant shortcomings in energy regulatory policy has been the consistent implementation of market mechanisms to incent supply-side resources without creation of comparable demand-side opportunities. This inherent bias toward supply-side resources undermines the development of functional markets and leads to one-way, large-scale wealth transfers from consumers to suppliers. Without specific actions to balance the opportunities of generation owners and electricity consumers, existing wholesale market structures will never bring about effective competition. Even with the turmoil of rolling blackouts in California, no effective mechanism exists for end-use customer load to benefit fully from price-responsive behavior. The same is true in virtually every other region of the country.

The FERC has left the development of demand-responsiveness to the states and ISOs. The states and ISOs are making some progress to implement programs that provide incentive and opportunity for end-use customer loads to respond to high prices and capacity shortages. However, some of these efforts have been opposed by generators, which would continue to benefit from inflexible demand, and from transmission/

distribution companies, which would prefer to continue controlling their default end-use customer load even in the presence of retail access opportunities. For example, these circumstances have prompted PJM's independent Board to file a proposed "Economic Load Response Program," in additional to an "Emergency Load Response Program," because PJM's sector-based Members Committee did not have a sufficient number of demand-side votes to approve the program.[4] Unfortunately, positive ISO efforts continue to be obstructed by supply-side resources that are incented to "foot drag" and prevent development of such programs, because such programs would potentially decrease generators' ability to opportunistically price energy during peak periods. Just like a generator that offers supply increments, end-use customer loads that offer load decrements should be paid to curtail, based on the market pricing schemes in place in each region. End-users can and do (in the few limited load response programs available today) function in the same manner as supply-side resources by effectively selling back their energy to the market, enhancing regional reliability, and mitigating price volatility. More must be done to overcome incumbent supply-side resources' effective delay of meaningful load responses programs that are critically needed as a check on generators' ability to opportunistically price energy during periods of system constraints.

Opportunities and incentives for end-use customer loads to respond better to capacity shortages and high prices are a critical missing element of truly competitive wholesale markets. Many market participants understand that such opportunities must be encouraged; however, out of self-interest, many market participants stop short of

[4] A copy of PJM's March 30, 2001 filing can be found under the "FERC Filings" sections of PJM's website at www.pjm.com.

supporting such initiatives. Regulators must play a more active role to ensure that this missing element of competitive markets becomes reality.

4. ISOs and RTOs Must Permit End-Use Customers to Play A More Active Role In the Development of Market Structures and Rules.

The Northeastern ISOs – PJM, ISO New England, and the NYISO – permit end-users to play an active role in the development of market structures and rules. In PJM, for example, end-users are permitted to cast 25% of total votes in the PJM Members Committee. In NEPOOL, end-users are permitted to cast 20% of total votes. This level of ISO/RTO voting participation, although not equivalent to the combined voting power of supply-side resources, is critical to the development of market structures and rules that do not unduly favor supply-side responses to market development issues. Industrial Customers' experience is that supply-side resources regularly attempt to block, through ISO/RTO governance structures, useful improvement in market rules that may further mitigate or prevent the exercise of market power. Industrial Customers believe that the best remedy is to provide more weight to end-use customers' interests within ISO/RTO governance structures.

Although existing governance structures provide a useful starting point for eliminating the bias toward supply-side resources, the ISO/RTO's management must continue to be encouraged to address market design flaws unilaterally when no consensus can be reached, as permitted by the governance rules for existing ISOs and many proposed RTOs. Recent actions by PJM to identify and file market rule corrections to prevent gaming opportunities in daily Capacity Credit Markets exemplifies the benefit of an independent MMU and an independent ISO staff in detecting and remedying market

design flaws.[5] PJM and other ISOs and RTOs must continue to play an active role in detecting and correcting market design flaws and the exercise of market power. Methods should be found to encourage existing and future ISO/RTO Boards to take independent actions that further the economic efficiency of markets. However, independent Board action cannot and should not substitute for well-balanced stakeholder governance.

Industrial end-users have attempted to play, and will continue to play if permitted, a very active role in ISO governance. Many industrial end-users participate directly in PJM, NYISO, NEPOOL, and Midwest ISO governance structures, and continue to provide demand-side perspectives in a process that is otherwise dominated by supply-side resources. Opportunities for direct demand-side participation in the development of wholesale market rules is critical to the development of market rules and structures that appropriately balance supply-side and demand-side opportunities.

[5] As an indication of the customer impact of a PJM market design flaw, the difference between $0/MW/day and $177/MW/day for the 90-day period January 1 and March 31, for 50,000 MWs of ICAP obligation, equates to approximately $0.8 billion.

CONCLUSION

Effective retail competition in any state is dependent upon the development of efficient and functional wholesale power markets. Wholesale markets will evolve in a useful manner only if seams are eliminated; opportunities and incentives for demand-side resources are appropriately balanced with supply-side resources; market power is prevented, detected, and eliminated; and demand-side resources are permitted to participate actively in the shaping of wholesale market structures. The FTC must recognize that these prerequisites to effective retail competition have not been satisfied to date, due in part to continued domination by incumbent providers of supply-side services and the FERC's unwillingness to be more proactive in functionally or physically separating monopoly transmission from generation. ISO/RTO governance structures must continue to evolve in order to effectively eliminate that bias, and ISOs/RTOs must be encouraged to address market flaws unilaterally if stakeholder consensus is not possible. These are all necessary ingredients to successful implementation of retail access.

Industrial Customers appreciate the opportunity to submit these Comments.